

***United States Court of Appeals
for the Second Circuit***



**PETITIONER'S
BRIEF**

77-4057

IN THE
United States Court of Appeals
FOR THE SECOND CIRCUIT

AMERICAN TELEPHONE & TELEGRAPH CO.,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION
and UNITED STATES OF AMERICA,
Respondents.

and Consolidated Cases Nos. 77-4067, 77-4068,
77-4073, 77-4074, and 77-4075

On Petitions to Review Order of
the Federal Communications Commission

BRIEF FOR PETITIONER
TELENET COMMUNICATIONS CORPORATION

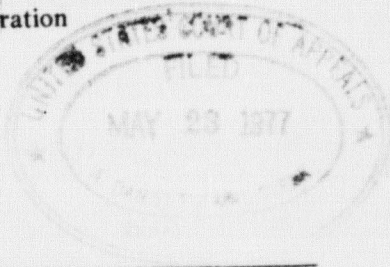
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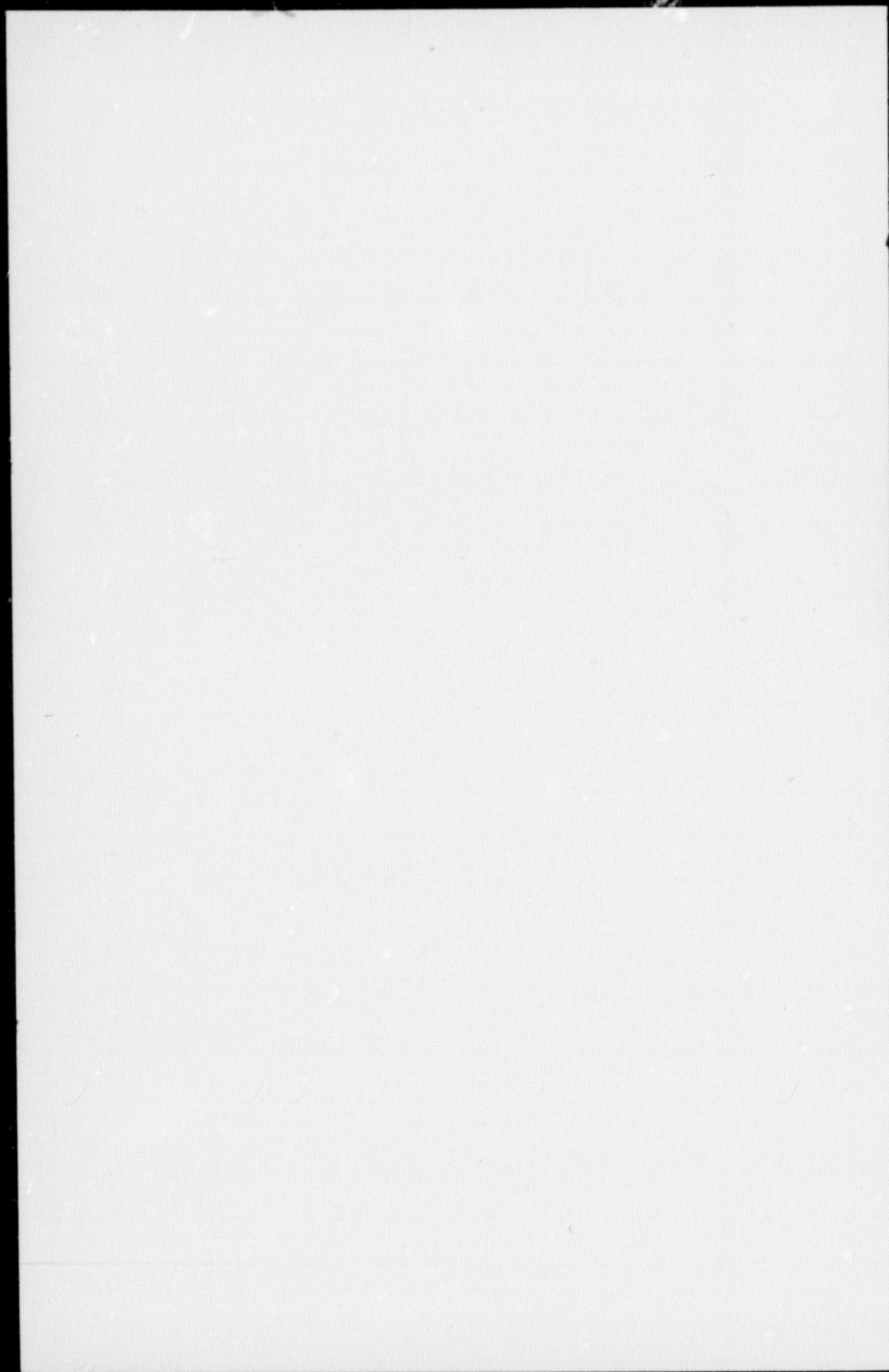


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ISSUES PRESENTED*

1. Whether the Commission's finding of unlawfulness as to *all* tariff restrictions upon the sharing of private line services is supported by the record and by reasoned analysis, or, rather, is unreasoned and unsupported, and thus, arbitrary.

*This case has not been before this Court previously, although a companion case (Case No. 77-4057) was before this Court upon the Motion for Stay of AT&T argued and denied on March 22, 1977.

2. Whether the Commission's refusal to adopt any regulatory safeguards to ensure that "unlimited sharing" does not become unregulated and unlawful resale amounts to an abdication of its statutory duties.

REFERENCES TO PARTIES AND RULINGS

Under review here are the July 1, 1976 Report and Order of the Federal Communications Commission (J.A., pp. 28-148), reported at 60 F.C.C.2d 261 (1976); and its Memorandum Opinion and Order on reconsideration, adopted January 5, 1977 (J.A., pp. 152-172), not yet reported.

Petitioner Telenet Communications Corporation is a communications common carrier fully subject to the jurisdiction of the Federal Communications Commission under Title II of the Communications Act of 1934, as amended: 47 U.S.C. §§ 201 *et seq.* Telenet offers a computer-based public data communications service utilizing transmission facilities leased by it from other carriers, and thus is a "resale" carrier as that term has been defined by the Commission in its Orders under review.

STATEMENT OF THE CASE

Historically, the private line tariffs of AT&T and Western Union have prohibited a customer of the carrier from transmitting communications for others, or from receiving a payment from others for use of the customer's service, but have permitted three general types of sharing:

- (a) "Authorized Use" — where a customer authorizes other entities in the same type of business to be connected to the customer's lines, for the transmission of communications to or from the customer, relating to matters of common concern among the customer and its authorized users.

- (b) "Joint Use" — where a customer with a communications need of its own identifies to the carrier other users of the shared service and specifies how the cost of the service is to be apportioned among those users. No common business interest, or communication between the customer and its joint users, is required.
- (c) "Single Customer" — where, by specific exception from general tariff requirements that a customer have a communications requirement of its own, certain entities are permitted to acquire facilities and services solely for the communications use of other non-customer entities. An example of such a "single customer" is Aeronautical Radio, Inc. (ARINC), a non-profit association of airline companies which obtains bulk private line facilities from AT&T for the use of ARINC's member airlines.¹

In 1974, the Commission instituted Docket No. 20097 with a Notice of Inquiry and Proposed Rulemaking, in response to rulemaking petitions filed by the Western Union Telegraph Corp. and MCI Telecommunications Corp.

The Notice of Inquiry set forth for resolution issues concerning limitations upon the resale and sharing of private line services, contained in the tariffs of AT&T and Western Union; the "single customer" provisions in the tariffs of those two carriers (See Footnote 1, *supra*); whether, and to what extent, the Commission should regulate sharing arrangements to preserve "a clear distinction between

¹The complaint of the American Trucking Association (ATA), that the exceptional treatment accorded the airline industry unlawfully discriminated against competing modes of transportation which were not accorded such status, resulted in the institution of proceedings in 1973 which were absorbed by the broader inquiry into resale and sharing in Docket No. 20097.

sharing and resale" (J.A., p. 25); and the manner in which the Commission should regulate entities (such as Petitioner Telenet) engaged in "reselling" communications services and facilities.²

Following three rounds of written comments, but without evidentiary proceedings or oral argument, the Commission on July 1, 1976, adopted its Report and Order decreeing, on an industry-wide basis, that existing tariff provisions limiting or prohibiting the resale or sharing of private line communications services and facilities are unreasonable, discriminatory, and unlawful, and directing that carriers subject to its jurisdiction file revised tariffs "eliminating restrictions on the resale and shared use of their services." While the Commission reconfirmed its prior holdings that "resale" was a carrier activity, to be conducted only pursuant to Commission regulation, the Commission expressly declined to adopt any rules governing "sharing" arrangements.

²At the time that the proceedings in Docket 20097 were instituted, three "resale" carriers had been authorized by the Commission, but none were operational. Telenet commenced operations pursuant to tariff in August 1975, and currently provides service in 45 cities across the United States, as well as to Canada and Mexico. As a "resale" carrier, Telenet leases basic transmission capacity from AT&T (an "underlying carrier"), which it interconnects with switching computers in Telenet offices throughout the United States. It offers to the public a sophisticated computer-based data communications service known as "packet-switching", permitting the rapid transmission of error-free data between customer terminals and computers.

The concept of one carrier leasing transmission facilities from another carrier for "resale" is not a recent development: In *MacKay Radio and Telegraph Company*, 6 FCC 562 (1938), the Commission held that the lease of facilities from Postal Telegraph Company by MacKay Radio required Commission certification pursuant to §214 of the Communications Act. Western Union, as well as other carriers, have for many years obtained transmission facilities from the Bell System for use in their public offerings.

On reconsideration, Telenet and several other parties expressed particular concern with the Commission's "unlimited sharing" policy, on the grounds that

- (a) specific types of sharing arrangements described with approval by the Commission involved elements of profit in direct conflict with the Commission's "non-profit" definition of sharing; and
- (b) the Commission's refusal to adopt regulations and procedures for the review of sharing arrangements effectively invites the development of resale activities posing as sharing, unfettered by regulation, but in reality competing with regulated carriers in the provision of communications services and facilities.

In its January 1977 Memorandum Opinion, the Commission adhered to its original position on these points.

SUMMARY OF ARGUMENT

By the Orders under review, the Federal Communications Commission has adopted sweeping industry-wide policies, decreeing that

- (a) The "resale" of common carrier communications services and facilities is itself a common carrier activity, subject to Commission regulation pursuant to Title II of the Communications Act of 1934, as amended; and that common carrier tariff provisions preventing or restricting the resale of private line services by other regulated carriers are unlawful;
- (b) The "sharing" of private line services and facilities by multiple users is a permissible non-common carrier activity, even when undertaken by intermediaries who add enhancing features (such as computer switching) to the "shared" facilities and realize a profit thereon;

- (c) Common carrier tariff provisions restricting the "sharing" of such services by unregulated entities are unlawful; and
- (d) No Commission regulations to prevent unlawful "resale" from passing as non-profit sharing are warranted.

The Commission's disposition of the "resale" issues was proper. The proposition that resale is itself a common carrier activity is compelled by both legal precedent and practical necessity: With the possible exception of AT&T and the Bell operating companies, virtually every interstate and international carrier is engaged, in part, in the "resale" of transmission facilities owned by other carriers.

Similarly, the conclusion that a common carrier may not prohibit other carriers from leasing and reselling its services and facilities is merely a restatement of the familiar anti-trust principle that a monopolist who controls access to an essential facility to do business must make it available on reasonable and non-discriminatory terms: See *Associated Press v. United States*, 326 U.S. 1, 65 S.Ct. 1416, 89 L.Ed. 2013 (1945); *United States v. Terminal R.R. Ass'n of St. Louis*, 224 U.S. 383, 32 S.Ct. 507, 56 L.Ed. 810 (1912); *Otter Tail Power Co. v. United States*, 410 U.S. 366, 93 S.Ct. 1022, 35 L.Ed.2d 359 (1973); rehearing denied, 411 U.S. 910, 93 S.Ct. 1523, 36 L.Ed.2d 201.

Thus, the Commission's conclusion that existing tariff restrictions upon the ability of a "resale" entity to acquire carrier facilities and services are unlawful, and must be eliminated, was totally proper and correct. The Commission erred, however, in ruling that all tariff limitations upon "sharing" were equally unlawful, and in refusing to adopt regulations of its own to ensure that any resulting sharing arrangements would be *bona fide* non-profit activities, rather than disguised "resale".

While the Commission has correctly defined permissible "sharing" as a non-profit activity,³ it has simultaneously approved several types of structural arrangements for sharing which on their face involve "profit" in the accepted economic sense, and which invite further illicit resale. The Commission's expressed views as to what constitutes "profit" are both simplistic and naive, and are totally unsupported in either the record below or in normal human experience.

Historically, the existing carriers, through tariff restrictions upon the permissible forms which "sharing" might take, and upon the economic arrangements among sharing users, have operated as a generally effective barrier to unregulated (and hence unlawful) resale. By requiring the elimination of these tariff restrictions, while at the same time refusing to adopt meaningful regulations of its own, the Commission has abdicated its statutory duty to ensure that those who engage in the provision of interstate communications for hire do so in accordance with Title II of the Communications Act.

In its July 1976 Report and Order, the Commission has conceded that its conclusions rest upon "expectations" for which there is little record support — but asserts that it is sufficient that these expectations be "reasonable conclusions." (J.A., p. 83). Manifestly, a number of these expectations are not reasonable conclusions at all, but represent no more than speculation and wishful thinking on the Commission's part.

³"Sharing" is "a non-profit arrangement in which several users, perhaps having no community of interest other than to communicate between the same two geographic points or to communicate with each other, collectively use communications services and facilities . . ." (J.A., p. 46).

ARGUMENT

The scope of Telenet's appeal to this Court is quite narrow: It supports the Commission's holdings that the "resale" of communications services and facilities is a common carrier activity which requires Commission regulation pursuant to Title II of the Communications Act; it supports the conclusion that, to the extent that one carrier by tariff provision seeks to limit the ability of another carrier to acquire and resell its services and facilities, such tariff provisions are unlawful; and it supports the conclusion that selective "single customer" tariff provisions are unlawful to the extent that they permit some users to realize economies through bundling their communications needs while denying that privilege to other users.

What Telenet challenges here is the particular combination of Commission actions relating to unregulated sharing of communications services, a combination which seems certain to lead to wholesale violations of the Communications Act by entities offering communications services for hire under the cloak of "non-profit sharing".

Heretofore, the established carriers' tariffs have served to limit sharing in such a manner that disguised resale was effectively precluded.⁴ While it is possible that these provisions may have been too limited in some respects,⁵ the Commission has failed to articulate its reasons for concluding that only *unlimited* sharing will serve the public interest, rather than some intermediate set of tariff criteria. In any event, having effectively eliminated any carrier-

⁴Specific challenges to several for-profit sharing activities in the past have resulted in the legitimization of such activities by the challenged entity seeking and acquiring carrier status: See *Graphnet Systems, Inc.*, 44 FCC2d 800 (1974); *Tymnet, Inc.*, ___ FCC2d ___ (1976).

⁵Aside from complaints concerning the "single customer" discriminations, no commenting users complained that the scope of the "joint use" or "authorized use" provisions of the AT&T and Western Union tariffs was too narrow or otherwise restrictive.

imposed restraints upon sharing, it was incumbent upon the Commission to adopt regulations of its own which would serve to prevent unregulated resale of communications services. Its failure to do so — and its affirmative approval of several types of sharing arrangements which are inherently offerings of communications for hire — are the basis of Telenet's appeal.

In its July 1976 Report and Order, the Commission properly defined sharing as

"a *non-profit* arrangement in which several users, perhaps having no community of interest other than to communicate between the same two geographic points or to communicate with each other, collectively use communications services and facilities obtained from an underlying carrier or resale carrier, with each user paying the communications-related costs associated with subscription to and collective use of the communications services and facilities according to its pro rata usage of such communications services and facilities." (J.A., p. 46; emphasis added).

However, the Commission later noted that

"three forms of sharing may reasonably be anticipated as a result of our decision:

- (a) Sharing through a non-profit intermediary;
- (b) 'Pure' sharing wherein two or more users combine their needs to share only the costs of communications line service; and
- (c) Sharing, either through a for-profit intermediary or in an arrangement wherein one user is the primary user, in which line costs and charges associated with 'augmented' services are shared according to usage. In this case, no management fee may be charged

unless the payment is made to an entity other than a sharing participant." (J.A., p. 108.)

The Commission acknowledged its anticipation that

"sharing will be more widely characterized by an individual or a for-profit corporation taking the lead role (either as an intermediary responsible for paying the carrier the entire tariff charge or as a primary user of the service), and providing the other users with other services augmenting the communications service." (J.A., p. 103).

Despite its recognition that such an arrangement permits "a number of possible abuses" (*Ibid*), the Commission rejected all suggestions that it adopt procedures designed to minimize such abuses.

Among the suggestions which had been made to the Commission were that it

- (a) limit the number of entities which might join in a single sharing arrangement, either absolutely or through the imposition of reporting requirements on large multi-user sharing arrangements;
- (b) preclude any charge by one sharing party to other sharing parties for augmentation of the basic communications services or for management fees; and
- (c) impose periodic reporting requirements as to sharing arrangements.

Aside from precluding the charge of a "management fee" by one of the "sharing participants", unless it were a "non-profit intermediary", the Commission rejected each of these suggestions with little or no discussion. Moreover, while the Commission holds that it would be inconsistent with non-profit sharing for a network management fee to be charged by one sharing entity to the other users, it would

permit "network management to be provided by an outside entity, so long as no *sharer* obtains a profit therefrom" (J.A., p. 105; emphasis supplied).

Telenet submits that the Commission's decision concerning permissible forms of sharing is internally inconsistent, irrational, and arbitrary. First, the fact that an "intermediary" is a "non-profit" entity provides no basis for exempting it from Title II regulation if in reality it is offering communications services for hire,⁶ nor does the fact eliminate concern that profit on the sharing arrangement is being realized. Many "non-profit" corporations undertake commercial activities producing operating income ("profit") which is distributed to the manager (in the form of salaries); to the founders of the enterprise (in the form of interest on loans); and, perhaps, to worthy charities.⁷ To assume that a "non-profit" entity lacks a profit motive is to ignore economic reality. Any enterprise requires capital, and whether capital is invested in the form of dividend-earning equity or interest-earning loans is immaterial to the need of the enterprise to realize operating "profits" to meet the cost of such capital. Also, the entity may well seek a profit on certain of its activities in order to generate funds with which to subsidize other activities. Thus, the conclusion that a "non-profit intermediary" eliminates the realization of profit in the "sharing" of communications services or facilities is just simplistic.

⁶Section 3(h) of the Communications Act of 1934, as amended, defines "common carrier" as

"any person engaged as a common carrier for hire, in interstate or foreign communication by wire or radio . . ."; 47 USC §153(h), emphasis added.

No statutory exemption for non-profit entities exists.

⁷As Telenet pointed out in its Petition for Reconsideration (J.A., p. 1524), several licensees of *commercial* broadcast stations are "non-profit" corporations.

Secondly, to permit an unregulated entity to realize an unsupervised fee for augmentation and management services, even where it is a for-profit intermediary or some other entity not participating directly in the sharing arrangement, is to *invite* the very abuses which the Commission has conceded are "possible".

The Commission has, in effect, defined common carrier activities not in terms of the activities themselves but in terms of the structure of the offeror. The difference between a resale broker and a for-profit network manager and "augmentor" is semantic, not substantive.⁸ The services offered to the end user may be identical; the cost may be the same; and the potential for profit is equal, but the broker is regulated while the "intermediary" is not.

In its January 1977 Memorandum Opinion disposing of petitions for reconsideration, the Commission rejected the arguments of Telenet and others that the "profit" or "non-profit" nature of an intermediary was not an appropriate

⁸As an illustration of the mere semantic differences between unregulated "sharing" and regulated "resale", consider the activities of Telenet itself. Telenet offers its communications service to the public, for hire, and seeks to make a profit on such offering. Clearly, the Commission intended to continue to subject Telenet to regulation as a common carrier. Yet, under the sharing criteria adopted by the Commission, Telenet could apparently avoid such carrier status by arranging to have one of its customers lease from an underlying carrier all of the commonly-used lines in Telenet's network, to be "shared" with the other Telenet customers. Telenet, as a "for-profit intermediary", would provide "augmentation" and "management" services (operation of the network's packet-switching equipment, marketing, accounting, and so forth), and would be free to earn a profit on these activities.

As a non-common carrier, Telenet would be free to charge similarly-situated users disparately; to arbitrarily refuse service to others; to subsidize its network services with profits from other activities, or vice-versa; and to engage in other activities (e.g., data processing) forbidden to common carriers. And Telenet would, of course, continue to compete with other carriers, just as it does today.

factor for determining whether a particular activity was common carriage; and that its grant to intermediaries of the ability to realize profit on management or augmentation of the shared facilities invited resale disguised as sharing.

The Commission claimed that it had "heretofore used profit as a criterion upon which our jurisdiction is determined. See *Industrial Radiolocation Service*, 5 FCC2d 197 (1966)" (J.A., p. 169), and that its "decision herein is thus consistent with that set forth in *Land Mobile Radio Services*, 46 FCC2d 752 (1974), affirmed *sub nom*, *N.A.R.U.C. v. F.C.C.*, 525 F2d 630 (D.C. Cir. 1976).]"⁹ (J.A., p. 169).

Industrial Radiolocation provides no support for the Commission's position. There, the Commission merely held that "radio facilities licensed in the radiolocation service are not used and cannot properly be used to transmit any intelligence of the design and choice of the subscriber to the service", and thus were not being used to provide common carrier services (5 FCC2d at 202). Profit, or the lack thereof, was not even discussed.

The Commission's reliance on the *Land Mobile* decision and its judicial affirmance is also misplaced: The Commission there authorized the licensing of commercial entities for the provision of radio dispatch and radio telephone service to the public on a non-common carrier basis.¹⁰ Although it expressly recognized that these "could be licensed as common carriers and regulated under Title II of the Communications Act" (46 FCC2d at 763), it chose

⁹Certiorari denied *sub nom* *National Association of Radio-Telephone Systems v. F.C.C.*, _____ U.S. _____, 96 S.Ct. 2203 (1976).

¹⁰While the Commission also authorized the formation of non-profit entities to be licensed to serve the dispatch needs of user groups (such as police and fire departments) which would be eligible licensees of such systems in their own right, there was no suggestion in the decision that such services would be common carriage but for the non-profit nature of the licensees.

to utilize instead its Title III licensing jurisdiction to fashion a more flexible regulatory structure for such entities.¹¹ The Court's affirmance was limited to the result reached — and not to the Commission's rationale. In fact, the Court specifically rejected the very type of logic upon which the Commission has rested its unlimited sharing decree, stating:

“... Further, we reject those parts of the Orders which imply an unfettered discretion in the Commission to confer or not confer common carrier status on a given entity, depending upon the regulatory goals it seeks to achieve. The common law definition of common carrier is sufficiently definite as not to admit of agency discretion in the classification of operating communications entities. A particular system is a common carrier by virtue of its functions, rather than because it is declared to be so. Thus, we affirm the Commission's classification not because it has any significant discretion in determining who is a common carrier, but because we find nothing in the record or the common carrier definition to cast doubt on its conclusions that SMRS are not common carriers. If practice and experience show the SMRS to be common carriers, then the Commission must determine its responsibilities from the language of the Title II common carrier provisions. (525 F2d at 644; Footnotes omitted.)

In response to Telenet's argument that allowance of a profit for management and augmentation by a non-sharing intermediary, and for augmentation by a sharing intermediary, renders the activity unregulated resale, the Commission first mischaracterized that argument

¹¹Here, by contrast, sharing intermediaries will not be subject to *any* regulation.

("Telenet advocates the position that the abuses of unregulated sharing are made possible if *anyone* connected with the sharing arrangement operates as a profit-making entity" J.A., p. 169), and then dismissed it with a series of illogical and non-sequitur statements:

"We believe . . . that it would unduly restrict the creation of sharing arrangements to adopt Telenet's position." (*Ibid.*).

(Of course, adoption of Telenet's position would "restrict the creation of sharing arrangements" to those that are legitimately non-profit — hardly an *undue* restraint.)

"... it is questionable whether the mere provision of advice and management, especially by an entity with no obligation to the carrier, is sufficient to confer Commission regulation over the sharing arrangement". (*Ibid.*).

(The Commission totally ignores the for-profit sale of "augmentation" allowed by its *Order* on an unregulated basis by a sharing intermediary. Examples of the "augmentation" which the intermediary could add, and charge his co-users for, include (a) switching of voice and data traffic, (b) channelizing equipment, and (c) computers and associated software: A resale carrier's "augmentation" may be identical to these.)

In reaching its conclusions, the Commission conceded — as it must — that record support for them was largely lacking:

"We believe that resolution of many of the issues in this proceeding need not await development of detailed proof of the benefits. It is sufficient that our expectations be reasonable conclusions. *National Association of Regulatory Commissioners v. F.C.C.*, 525 F2d 630 (D.C. Cir. 1976)." (J.A., p. 83)

Perhaps the most reasonable of the Commission's expectations was set forth at an earlier point in its July Order:

"81. We foresee *expanded* resale and *sharing* as resulting in the future development of a two-tiered interstate telecommunications industry and market structure. The first tier will be comprised of carriers offering basic communications channels and switching services in two markets — to the public at the "retail" level, and to other common carriers and resale carriers at the "wholesale" level. *The second tier will be comprised of carriers and other entities leasing the preponderance of their communications plant from the first tier carriers for the ultimate purpose of reselling these to the public sector — either directly in the form of point-to-point communications channels, or implicitly, when these channels and switching facilities are combined to form a switched private line data or voice communications services, or a communications based data processing service.*" (J.A., p. 80, emphasis added, Footnote omitted).

The realization of this expectation is the essence of Telenet's concern: The Commission has authorized unregulated "sharing" intermediaries to enter the second-tier communications market in direct competition with regulated resale carriers.

Of the participating parties, only the Office of Telecommunications Policy had urged a policy of unrestricted sharing — and that suggestion was in the context of its broader proposition that neither resale nor sharing should be regulated as carrier activities. No party even suggested, much less demonstrated, the wisdom of a policy combining both regulated resale and unregulated, unlimited sharing.

As detailed *supra*, the Commission's conclusions regarding sharing are in part unreasonable, and in part contradictory and unintelligible. The Commission's anticipation of a broad "second tier" market of carriers and "other entities" engaged in the resale of augmented or brokered communications services and facilities (J.A., p. 80) is probably an accurate forecast, and stands in stark contrast to its expressions of belief in the altruism of sharing entities and intermediaries.

CONCLUSION

In short, the Commission's actions are unreasonable, arbitrary, and amount to an abdication of its statutory responsibilities. The Communications Act requires the Commission to regulate under Title II all entities offering interstate common carrier services: It does not grant the Commission discretion to withhold such regulation as to any class of such entities. The Commission's decree that all tariff restrictions upon sharing are unlawful, and its permissive expressions of acceptable market activity by sharing intermediaries, when coupled with its refusal to adopt meaningful regulations to ensure that unlimited sharing does not develop into unregulated resale, virtually guarantees that illicit resale — unregulated common carriage — will result. Accordingly, Petitioner Telenet urges this Court to set aside the Commission's Orders insofar as they authorize unregulated and unlimited sharing, and remand the proceeding to the Commission with a directive that it fulfill its statutory mandate to regulate all entities whose activities constitute common carriage for hire.

Respectfully submitted,

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